

## What is a SARSEP?

(Salary Reduction Simplified Employee Pension)

- Written arrangement set up before 1997.
- Arrangement where employees choose to have some of their pay deposited directly into their IRAs. Employer contributions are also allowed.
- Covers employees who are at least age 21, have worked for you in 3 out of the last 5 years and have total compensation for the year of at least \$450.

## Common problems

We found the following problems in a national sample of examined SARSEPs:

### • Failure of deferral percentage test

The amount each Highly Compensated Employee (HCE) may defer is limited. The deferral percentage test for a SARSEP compares the deferral percentage of each HCE with the average of the deferral percentages of all

other eligible employees. For further information on how to perform this test, please refer to your plan document, or the Instructions for **Form 5305A-SEP**, *Salary Reduction and Other Elective Simplified Employee Pension - Individual Retirement Accounts Contribution Agreement* or **Pub 560**, *Retirement Plans for Small Business*.

### • Failure to make the required top-heavy contributions

Many SARSEPs, including model SARSEPs (Form 5305A-SEP), require top-heavy contributions. In general, the employer makes a 3% minimum top-heavy contribution for each eligible employee who is not a key employee.

### • Violation of the 25 eligible employee rule

If you had more than 25 eligible employees at any time during the prior year, then you cannot accept deferrals in the current year.

### • Violation of 50% rule

At least 50% of the eligible employees must elect to make deferrals to the plan in a year or all deferrals made during the year are disallowed.

### • Violation of Contribution Limit

Contributions are limited to 25% of each eligible employee's compensation.

### • Failure to timely amend plan document

In order to maintain their tax-advantaged status, many SARSEPs must be amended for current law. If you have a model SARSEP, to take advantage of new law changes, you **must** adopt the current version of the model **Form 5305A-SEP**(Rev. 3/02).

*For additional information, including current-year indexed limits and definitions, please visit us online at [www.irs.gov/ep](http://www.irs.gov/ep), select "More Topics" and click on "Retirement Plans for Small Businesses".*

## SOLUTIONS...

If your SARSEP has these problems, please take steps to bring your plan into compliance so that you can continue to provide your employees with retirement benefits on a tax-favored basis. You may want to contact a professional for help.

You can also correct these and other plan problems through the Employee Plans Compliance Resolution System (EPCRS).

For more information on this program please see CORRECTIONS online at [www.irs.gov/ep](http://www.irs.gov/ep) or consult:

- **Publication 4050**, *Retirement Plan Correction Programs (CD-ROM)*
- **Publication 4224**, *Retirement Plan Correction Programs*
- Revenue Procedure 2003-44
- **Publication 560**, *Retirement Plans for Small Business*
- **Publication 590**, *Individual Retirement Arrangements (IRAs)*
- **Publication 3998**, *Choosing A Retirement Solution for Your Small Business*

If you need more specific guidance or have questions, you can reach us by any of the following methods:

- **By Phone**  
Customer Account Services  
1-877-829-5500
- **By E-Mail**  
Visit the "EP Customer Account Services" section of the Retirement Plans web page at [www.irs.gov/ep](http://www.irs.gov/ep) under the "Topics" section.
- **By Mail**  
Internal Revenue Service  
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# SARSEP

## Common Problems & Solutions